

UNITED STATES BANKRUPTCY COURT
EASTERN DISTRICT OF WASHINGTON

In Re:)
PAMELA ROBIN RILEY,) No. 04-07122-PCW7
Debtor.) MEMORANDUM DECISION RE:
OBJECTION TO EXEMPTIONS

THIS MATTER came before the Honorable Patricia C. Williams on July 12, 2007 upon (1) creditor Spokane Radio Inc.'s (hereinafter "KXLY") Objection to Debtor's Exemptions (Docket No. 41) and (2) Objection to the Trustee's Motion for Order Authorizing Trustee to Settle Trustee's Objection to Exemptions and to Reject Cash Offer to Settle Claim (Docket No. 73). The Court reviewed the files and records herein, heard argument of counsel and was fully advised in the premises. The Court now renders its Memorandum Decision.

FACTS

This Chapter 7 debtor was employed by KXLY until December 31, 2002, when the employment was terminated. In February 2003, the debtor met with her state court counsel to discuss that termination and signed a fee agreement with that counsel in May 2003. Debtor filed a Human Rights Commission Complaint in June 2003, as a result of the employment termination and commenced the state court action alleging wrongful termination in August 2005.

On September 24, 2004, the debtor filed her Chapter 7 petition

1 and schedules, but did not disclose the existence of her claim
2 against KXLY. The discharge was entered December 30, 2004. A "no
3 asset" report was filed by the Trustee, and the case was closed
4 shortly thereafter.

5 In late December 2006, on the eve of a trial setting hearing
6 in state court, KXLY learned of the bankruptcy filing and promptly
7 contacted the Trustee. The Trustee moved to reopen the case on
8 January 19, 2007. The record is not clear, but apparently the
9 Trustee was joined as an additional plaintiff in the state court
10 action. The debtor, on January 24, 2007, filed an Amended Schedule
11 "B" listing the claim against KXLY and an Amended Schedule "C"
12 claiming certain proceeds of the claim exempt under federal law.
13 On February 26, 2007, the debtor filed a second Amended Schedule
14 "C" claiming certain proceeds of the claim exempt under state law.
15 It is the Second Amended Schedule "C" which is at issue. The
16 amended schedule claims \$16,150 exempt pursuant to
17 RCW 6.15.010(3)(f) relating to personal bodily injury and \$1,045
18 exempt pursuant to RCW 6.15.010(3)(b) relating to "other personal
19 property."

20 On February 2, 2007, KXLY filed a Proof of Claim in the
21 Chapter 7 proceeding in the amount of \$263.10 as it had acquired an
22 assignment of a claim in that amount from Spokane Emergency
23 Physicians, P.S. But for purchasing that claim, KXLY would not
24 have standing to object to debtor's exemptions. Having purchased
25 that right from Spokane Emergency Physicians, P.S., KXLY now
26 exercises its right to object. The acquisition of the creditor's
27 claim by KXLY was apparently a tactical maneuver.

28 KXLY argued that principles of judicial estoppel prevented the

1 debtor from receiving benefit from her undisclosed claim against
2 KXLY, thus reducing its liability on that claim. The Trustee also
3 objected to the debtor's exemptions, but the objection was resolved
4 by a settlement with the debtor (Docket No. 62). KXLY objected to
5 that settlement.

6 Trial in state court was delayed while various hearings
7 occurred before this court. This court ruled that any effort to
8 reduce KXLY's damages, assuming it was determined KXLY was liable
9 on the debtor's claim, should be addressed in the state court
10 proceeding. The parties proceeded to trial in state court, which
11 resulted in a jury verdict on May 18, 2007 holding KXLY liable on
12 the claim and awarding a judgment against KXLY in the amount of
13 \$75,000.¹ After entry of the jury verdict, KXLY filed a motion
14 with the state court seeking a reduction of any resulting judgment
15 based upon the equitable doctrine of judicial estoppel. KXLY
16 argued that principles of judicial estoppel precluded the debtor
17 from benefitting from the jury verdict. Because the debtor did not
18 list the claim against KXLY in her original schedules and did not
19 initially inform the bankruptcy Trustee of the claim, KXLY
20 requested that the judgment be reduced to an amount sufficient only
21 to pay the Chapter 7 administrative expenses and creditors, thus
22 precluding the debtor from receiving any benefit of her claim
23 against KXLY.

24 The state court conducted a post-trial evidentiary hearing to
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26 ¹As of the date of hearing in this matter, the final judgment
27 was being prepared for presentment to the state court as was a
28 separate judgment for an award of attorney fees for debtor's state
court counsel, who was also employed by the bankruptcy estate. The
attorney fee award is not at issue in this bankruptcy.

1 determine the applicability of judicial estoppel to the debtor,
2 leaving it to this court to determine the applicability of judicial
3 estoppel to the Trustee. The state court found as a matter of law
4 that in September 2004, when the bankruptcy was filed, the debtor
5 had all relevant information to know that she held a claim. The
6 failure to list the claim on the initial bankruptcy schedules was
7 inconsistent with the debtor's pursuit of the claim before the
8 Human Rights Commission and the state court. The debtor benefitted
9 from that inconsistent position by obtaining a discharge in
10 December 2004, relieving her from liability to her creditors while
11 simultaneously seeking to recover money damages on her claim. The
12 state court then found that the debtor "simply did not understand"
13 that she had to list the claim nor did she understand the meaning
14 of the schedules as they related to a contingent claim.

15 After analyzing the policy underlying the doctrine, i.e., the
16 protection and preservation of the integrity of the judicial
17 system, the state court determined that the doctrine was
18 inapplicable. The jury had determined that a wrongful act had
19 occurred and that damages in the amount of \$75,000 had resulted.
20 In order to protect the jury process, the judgment should not be
21 reduced.

22 Because the state court determined that the verdict should
23 remain unaffected, the issues before this court are whether the
24 resulting judgment should be paid to the Trustee and, if so, how it
25 should be distributed.

26 ISSUES

27 1. Is the Trustee judicially estopped from receiving the
28 judgment amount?

2. How should the judgment amount be distributed, specifically (a) should the debtor be allowed to claim a portion of it exempt and (b) is the debtor precluded from receiving any excess proceeds from a solvent estate?

ANALYSIS

The Trustee is not Judicially Estopped

There is no dispute that the claim against KXLY and any resulting judgment is property of the estate. The fact that the debtor did not list the claim against KXLY on her bankruptcy schedules does not prevent the Trustee from pursuing the claim once it was discovered. A debtor's concealment of an asset does not estop a bankruptcy Trustee from recovering the asset. *In re Riazuddin*, 363 B.R. 177 (10th Cir. B.A.P. 2007); *Arkison v. Ethan Allen, Inc.*, 160 Wn.2d 535, 160 P.3d 13 (2007). The judgment should be paid to the Trustee. The question then becomes one of distribution of the proceeds of the judgment.

Judicial Estoppel Does Not Prevent Distribution of Excess Estate Assets to the Debtor

This controversy regarding the debtor's right to exempt the proceeds of her claim against KXLY arose before any determination of the amount of proceeds or, indeed, before any determination of whether the claim was valid. This court declined to rule on the issue until the state court liquidated the claim. Now that the claim has been liquidated in the amount of \$75,000, the estate is solvent. Creditors' claims have been filed in the amount of

1 \$17,384.32.² The final amount of administrative expenses has not
2 been determined, but are currently estimated by the Trustee at
3 \$20,000. If the debtor's claim of exemption is allowed after
4 payment of administrative expenses of \$20,000, creditors' claims of
5 \$17,384.32, and the exempt amount of \$17,195 [a total of
6 \$54,579.32], the debtor would receive \$20,420.68 [\$75,000 -
7 \$54,579.32] as proceeds of the solvent estate. The total payable
8 to debtor would be \$37,615.68 [\$17,195 exempt + \$20,420.68
9 proceeds]. If debtor's exemption is disallowed, after payment of
10 administrative expenses of \$20,000 and creditors' claims of
11 \$17,384.32 [total \$37,384.32], the debtor would receive \$37,615.68
12 as proceeds of the solvent estate [\$75,000 - \$37,384.32]. Due to
13 the fact that the estate is solvent, the debtor would receive the
14 same amount whether the exemption is allowed or disallowed.

15 Whether the exemption is allowed or disallowed, all creditors,
16 including KXLY on its assigned claim, would receive full payment.
17 KXLY's position is that the application of the doctrine of judicial
18 estoppel precludes the debtor from receiving any benefit from the
19 judgment either by way of exemption or as excess proceeds of the
20 solvent estate.

21 The judgment in its entirety is an asset of the estate and
22 must be paid to the Trustee. The distribution of the asset must be
23 in accordance with the Bankruptcy Code which establishes a priority
24 of payment of claims against the estate. If all creditors and
25 administrative expenses are paid in full, any excess estate funds
26 must be distributed to the debtor. The fact that a debtor

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28 ²One Proof of Claim was filed without an amount. Also, the
claim of Beneficial was filed twice in the case.

1 initially conceals an asset does not make the asset disappear or
2 authorize the Trustee to retain it for his own benefit or to
3 distribute it as a windfall to creditors or distribute it to some
4 other entity. If a debtor conceals the existence of real property
5 or shares of stock, which are later identified and reduced to cash,
6 the initial concealment by the debtor does not effect the amount of
7 cash payable to the estate. Once the estate is fully administered,
8 any excess proceeds continue to exist regardless of the original
9 concealment.

10 Even assuming bad faith on the part of the debtor, the cash
11 proceeds of the concealed asset would continue to exist and would
12 be distributed. No authority exists for the proposition that a
13 debtor's concealment of an asset, which, after liquidation renders
14 the estate solvent, prevents distribution to the debtor of excess
15 proceeds once the estate is fully administered. Consequently,
16 based upon current information, the debtor in this particular case
17 will be receiving \$37,615.68, whether that sum consists of an
18 exempt amount and excess proceeds or whether the entire sum
19 represent excess proceeds from a solvent estate.

20 The administrative expenses in the case, however, have yet to
21 be finally determined. There is some ongoing activity in the state
22 court case and an appeal of its decision may occur. It is also
23 possible that this court's decision will be appealed. The
24 controversy regarding the right of the debtor to claim an exemption
25 in the judgment proceeds is not moot as it is unlikely, but
26 possible, that the administrative expenses could increase to an
27 amount sufficient to render the estate insolvent.

1 **The Exemption Should Be Disallowed**

2 It is not uncommon for a debtor to file an amended schedule of
3 exemptions seeking to exempt all or a portion of a previously
4 concealed or inadvertently undisclosed asset. Both B.R. 1009 and
5 B.R. 4003 are applicable to the amendment of exemptions and are
6 liberally constructed to allow such amendments. Such amendments
7 may be disallowed if the amendment was sought in bad faith or would
8 result in prejudice to creditors.

9 Exemptions can be amended at any time during the pendency
10 of a bankruptcy case. *Andermahr v. Barrus*, 30 B.R. 532,
11 534 (9th Cir. B.A.P. 1983). Indeed, bankruptcy courts
12 have no discretion to deny the amendment of exemptions
unless the amendment is proposed in bad faith or would
prejudice creditors.

13 *In re Rolland*, 317 B.R. 402, 414 (Bankr. C.D. Cal. 2004).

14 As the Trustee acknowledges, Rule 1009(a) states that
15 debtors may amend their schedules 'as a matter of course'
16 at any time before the case is closed. See *Michael*,
supra, 163 F.3d at 529; *Magallanes*, *supra*, 96 B.R. at
255-56. The rule is liberal, but is subject to some
judge-made exceptions:

17 Amendments are and should be liberally allowed at any
18 time absent a showing of **bad faith or prejudice** to third
19 parties. *In re White*, 61 B.R. 388, 394 (Bankr. W.D.
20 Wash. 1986); [*In re*] *Andermahr*, 30 B.R. [532] 533 [9th
21 Cir. BAP 1983]. Exceptional circumstances, however, may
prevent a debtor from amending his petition or schedules.
22 *Tignor [v. Parkinson]*, 729 F.2d [977] at 979 [4th Cir.
1984] [*overruled on other grounds as stated in In re*
Sherman, 191 B.R. 654, 657 n. 3 (Bankr. E.D. Va. 1995)];
In re Doan, 672 F.2d 831, 833 (11th Cir. 1982) (bad faith
by debtor or prejudice to creditors might bar amendment).

23 *Magallanes*, 96 B.R. at 256 (emphasis added).

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25 *In re Arnold*, 252 B.R. 778, 784 (9th Cir. B.A.P. 2000).

26 The question of whether the amended exemption should be
27 allowed must focus upon substantive bankruptcy law and rules rather
28 than the broader and more general principles of judicial estoppel.

1 However, the policy and considerations in allowing exemption of a
2 previously undisclosed asset under B.R. 1009 are closely related to
3 the policy and considerations of the doctrine of judicial estoppel.

4 Judicial estoppel is a common law doctrine applied by both
5 federal and state courts. Application of the doctrine of judicial
6 estoppel to the debtor's right to pursue a previously undisclosed
7 claim is a question of federal law. *In re Coastal Plains, Inc.*,
8 179 F.3d 197 (5th Cir. 1999). The principles of judicial estoppel
9 were articulated in *New Hampshire v. Maine*, 532 U.S. 742, 743
10 (2001):

11 Courts have recognized that the circumstances under which
12 judicial estoppel may appropriately be invoked are not
13 reducible to any general formulation. Nevertheless,
14 several factors typically inform the decision whether to
15 apply the doctrine in a particular case: First, a party's
16 later position must be clearly inconsistent with its
17 earlier position. Second, courts regularly inquire
18 whether the party has succeeded in persuading a court to
19 accept that party's earlier position, so that judicial
20 acceptance of an inconsistent position in a later
21 proceeding would create the perception that either the
22 first or the second court was misled.

23 Third, courts ask whether the party seeking to assert an
24 inconsistent position would derive an unfair advantage or
25 impose an unfair detriment on the opposing party if not
26 estopped. In enumerating these factors, this Court does
27 not establish inflexible prerequisites or an exhaustive
28 formula for determining the applicability of judicial
estoppel. Additional considerations may inform the
doctrine's application in specific factual contexts. Pp.
1814-1815.

23 The policy underlying the doctrine of judicial estoppel is the
24 protection and preservation of the judicial process. *In re Coastal*
25 *Plains, Inc.*, *supra*; *Hamilton v. State Farm Fire & Cas. Co.*, 270
26 F.3d 778 (9th Cir. 2001).

27 The same policy underlies substantive bankruptcy law applying
28 B.R. 1009 regarding amendments to exemptions. The duty of a debtor

1 to fully and accurately disclose the debtor's financial situation
2 and file accurate and complete schedules is fundamental to the
3 bankruptcy system. That affirmative and continuing duty is
4 integral to the bankruptcy process and of grave importance to the
5 court, the creditors, trustees and others. The policy underlying
6 the doctrine of judicial estoppel is the protection of the
7 integrity of the judicial process and, in a bankruptcy proceeding,
8 the integrity of the process is dependant upon a debtor's complete
9 and accurate completion of the schedules. Although not articulated
10 as the doctrine of judicial estoppel, the application and
11 interpretation of B.R. 1009(a) requires an analysis similar to that
12 common law doctrine. Simply put, a debtor is not allowed to later
13 exempt an undisclosed asset if the debtor's failure to disclose
14 arose from the bad faith or an intent to conceal.

15 An important consideration in the application of the equitable
16 doctrine of judicial estoppel is whether the debtor was making a
17 misrepresentation to the court or engaging in a tactic to gain an
18 unfair advantage or whether the debtor simply made an
19 understandable mistake. *Dunmore v. U.S.*, 358 F.3d 1107 (9th Cir.
20 2004); *Johnson v. State, Oregon Dept. of Human Resources,*
21 *Rehabilitation Div.*, 141 F.3d 1361 (9th Cir. 1998); *In re Grogan*,
22 300 B.R. 804 (Bankr. D. Utah 2003) (knowing failure to schedule a
23 personal injury claim). This consideration in the application of
24 judicial estoppel is analogous to the consideration of bad faith in
25 the application of B.R. 1009.

26 The state court determined as a matter of law that the debtor
27 knew of the evidence of the claim against KXLY when the bankruptcy
28 was commenced and determined as a matter of fact that her failure

1 to list the claim in the bankruptcy schedule was a failure to
2 understand rather than bad faith or a knowing effort to mislead.
3 That factual determination is binding on this court.

4 Pursuant to 28 U.S.C. § 1738, federal courts must give
5 preclusive effect to prior state judicial proceedings to the same
6 extent as accorded by the courts in that state. *Marrese v.*
7 *American Academy of Orthopaedic Surgeons*, 470 U.S. 373, 381 (1985).
8 In accordance with this mandate, federal bankruptcy courts are
9 similarly bound to give preclusive effect to findings of fact as
10 entered by state courts. *Kelleran v. Andrijevic*, 825 F.2d 692, 694
11 (2nd Cir. 1987), *cert. denied*, 484 U.S. 1007 (1988).

12 In applying B.R. 1009, however, harm to the parties in the
13 bankruptcy proceeding, typically the creditors, is an important
14 consideration. Bankruptcy courts have no discretion to deny the
15 amendments of exemptions unless the amendment is proposed in bad
16 faith or would prejudice creditors. *In re Arnold*, 252 B.R. 778 (9th
17 Cir. B.A.P. 2000); *In re Magallanes*, 96 B.R. 253 (9th Cir. B.A.P.
18 1988). See also, *In re Rolland*, *supra*; *In re Grogan*, *supra*.

19 If, as in this case, the failure to disclose was inadvertent,
20 a debtor is not allowed to later exempt an undisclosed asset if the
21 failure to disclose would prejudice creditors.

22 As stated in *In re Arnold*, *supra*, at page 785:

23 On the issue of 'prejudice' to third parties, there is an
24 additional requirement. '[M]erely showing prejudice' does
25 not automatically trigger disallowance of an amendment:
26 the court must balance the prejudice to the debtor of
disallowing the exemption against the prejudice to third
parties in allowing the exemption.

27 Prejudice to creditors does not necessarily occur merely
28 because an amended exemption relates to a previously undisclosed

1 asset. Delay in filing the amended exemption is a factor as is the
2 filing of repeated amendments. Any adverse consequence to the
3 bankruptcy estate, such as an increase in administrative expenses,
4 will result in a denial of the exemption.

5 In this case, the administrative expenses have increased due
6 to the amended exemption. Also, the controversy surrounding the
7 amended exemptions was a factor in delaying the state court trial.³
8 The totality of circumstances in this case results in the
9 conclusion that should the estate be rendered insolvent by future
10 events, creditors would be prejudiced by allowing the debtor's
11 claimed exemption which would outweigh any prejudice to the debtor.

12 **CONCLUSION**

13 The state court previously determined that the debtor was not
14 estopped from pursuing her claim against KXLY. This court has
15 determined that the trustee is not judicially estopped from
16 pursuing such claim. As to the debtor's right to an exemption in
17 the proceeds of such claim, Federal Law provides that amendments to
18 schedules should be liberally allowed at any time, absent a showing
19 of bad faith. The proceeds of that claim render the bankruptcy
20 estate solvent and debtor's failure to initially disclose the claim
21 does not deprive debtor of the right to receive the excess proceeds
22 from the solvent estate. As to the debtor's right to an exemption

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24 ³The first amended exemption was based upon federal law and
25 drew an objection on the basis that the exemption was improper.
26 That objection resulted in this second amended objection based on
27 state law. One basis of the objection is the impropriety of
28 claiming a bodily injury exemption under RCW 6.15.010(3)(f) for a
wrongful employment termination claim. That issue has not been
addressed due to the conclusion reached in this decision. This
decision also moots the objection to the Trustee's settlement with
the debtor regarding exemptions.

1 in the proceeds of such claim, application of substantive
2 bankruptcy law to the facts of this case precludes the debtor's
3 amended claim of exemption as allowing such amendment would
4 prejudice creditors. Therefore, that portion of the second amended
5 exemption relating to the claim against KXLY is **DENIED**.



Patricia C. Williams

Patricia C. Williams
Bankruptcy Judge

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